MEMORANDUM

To: Interested Regulators and Interested Parties

From: Director Judith French (OH), Co-Chair of the Risk-Based Capital Model Governance (EX) Task Force
Commissioner Nathan Houdek (WI), Co-Chair of the Risk-Based Capital Model Governance (EX) Task Force

Date: July 3, 2025

Re: Request for comments on proposed preliminary Risk-Based Capital principles and questions

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Context

The Risk-Based Capital (RBC) Model Governance (EX) Task Force (Task Force) published its *2025 Goals and Proposed Charges* (The Memo), which provides background and explains the need for expanded governance over the RBC framework. To that end, the Task Force requests comment on proposed preliminary principles and questions intended to be used for guidance.

Beyond the development of principles, the Task Force goals include a gap analysis of RBC components, an educational campaign, and an overarching governance framework. The interdependent nature of the goals requires a work plan that alternates between refinements to the preliminary principles and other efforts (e.g., development of a gap analysis of RBC components). At this formative stage, commenters should not expect formal adoptions of principles or other components of the governance framework until they have been demonstrated to provide an appropriate level of guidance later in the process.

The use of RBC and proposed principles. As explained in the RBC Preamble, the purpose of RBC is to identify potentially weakly capitalized companies. The proposed principles support this purpose and attempt to align with the goals and charges of the Task Force, which include developing principles that will "*serve as a strategic foundation to ensure that all revisions to the RBC framework are enhancements that uphold its integrity, adaptability, and global competitiveness and further the principle of Equal Capital for Equal Risk."* In addition, The Memo explains, the principles will provide guidance "*for updating the RBC formulas to address current investment trends with a focus on more RBC precision in the area of asset risk and to ensure that insurance capital requirements maintain their current strength and continue to appropriately balance solvency with the availability of products to meet consumer needs*."

The governance framework. While the Memo speaks to the principles, the broader governance framework will provide guidance for assessing and changing RBC calculations.

- **Principles** will be foundational to providing a guiding North Star for assessing and changing RBC components.
- **Quantitative guidelines** will articulate quantitative benchmarks allowing quantitative comparability across RBC calculations (e.g., statistical safety level). The guidelines serve as benchmarks, and not hard requirements. Deviations are expected but should be documented and justified.
- **Model Governance Standards** will provide a process for adjustments to RBC, incorporating regular reviews of RBC outcomes. This ensures that future adjustments are made in alignment with guiding principles and supporting guidelines.

- **Case studies for additional guidance**. Many RBC components will require additional guidance when assessing their characteristics and the materiality of a principle being violated. Since it is not often practical to construct quantitative thresholds, a series of case studies can provide further guidance.

The role of principles and broader governance framework in helping achieve the other Task Force 2025 goals:

1. Develop a list of gaps and inconsistencies in the RBC calculations and suggestions (solutions) for what could improve/address such gaps.
2. Develop a plan, including priorities and sequencing, for changes to RBC in future years.
3. Develop an education and public messaging campaign to highlight the RBC framework's benefits and strengths as an important part of the U.S. state-based insurance regulatory system. The campaign will help address the need for global insurance supervisors to understand differences across regulatory jurisdictions to effectively supervise these groups.
4. Create a process for analyzing both retrospective and future adjustments to RBC calculations, incorporating regular reviews of RBC calculations and ensuring future adjustments are made in alignment with guiding principles and quantitative guidelines. This process will facilitate ongoing improvements to ensure the framework remains responsive to emerging risks and market trends, enabling the RBC framework to adapt proactively.

The immediate priority is to provide options on proposed preliminary top-of-the-house RBC principles and life investments quantitative guidelines for regulators to choose, supporting the Task Force, whose focus is on *more RBC precision in the area of asset risk,* as described in The Memo. The initial work plan will sequence efforts in the following order, subject to iteration and revisions:

1. Top-of-the-house preliminary principles, with this request looking for comments on the proposed list below.
2. Preliminary quantitative guidelines for life investments RBC, with an exposure requesting comment targeted to be posted at the Summer National Meeting.
3. An initial gap analysis focusing on life RBC investments by year-end 2025.
4. An education and messaging campaign by year-end 2025.
5. A broader plan for other components of the RBC, including those of property & casualty and health, will be developed by year-end 2025.

<u>**Questions that the principles and broader framework should be used for guidance:**</u>

Memo questions that the principles should be used for guidance:

1. When should a particular risk be addressed in the RBC model?
2. What level and type of data and analysis are needed to support the setting of capital factors?
3. How should new and emerging risks and asset types be treated if a capital framework has not yet been developed for them?
4. What level of statistical safety is to be targeted by the model or, if not, a single target, and how should such tailored safety targets be determined?
5. When should the calibration of risks to capital factors be re-evaluated?

Additional questions for consideration:

6. How should the RBC calculations define and structure governance over model risk, including model development, documentation standards, validation, ongoing monitoring, and change management?
7. To what extent should RBC calculations align with Statutory Accounting Principles (SAP)? If alignment is pursued, how should the framework account for, say, valuation differences between directly held assets and securitized exposures, and how might these differences influence investment behavior or regulatory arbitrage?
8. How should reserves, valuation adjustments, or offsets (e.g., taxes or discounting) be considered?

9. How should existing principles (e.g., the American Academy of Actuaries' Principles for Structured Securities RBC), which regulators have endorsed, fit into the principles?
10. How should interaction/co-dependence of factors (e.g., C-1/C-3 and RBC Covariance) be recognized and treated?

<u>Proposed preliminary RBC principles, applied by company type:</u>

1. **Use of RBC calculations.** RBC calculations are used as a regulatory tool only to identify potentially weakly capitalized companies unless otherwise required by law, regulation, or supervisory standards. RBC calculations provide regulators with legal permission and/or requirements to intervene at various RBC levels.
    a. **Insolvency.**
        i. **Possibility of insolvency**. RBC charges should be set to reflect a level of safety that reduces the probability of insolvency, without eliminating the possibility of insolvency.
        ii. **RBC calculations should secondarily acknowledge their impact on product availability that meets consumer needs.** RBC charges should be sufficiently granular to recognize material differences in risk, particularly when they may materially affect insurer decisions that impact meeting consumer needs.
        iii. **Actions unrelated to solvency.** RBC charges should not serve to promote or inhibit actions by insurers that are unrelated to solvency risk.
        iv. **Identified risk.** Where identifiable, RBC charges should reflect measurable differences in risks that can impact solvency. The risks captured or not captured within RBC calculations should be identified. Adjustments should offset material risks that are captured in multiple calculations.
    b. **Insurance groups and global competitiveness.** While RBC calculations are designed to identify potentially weakly capitalized companies, they should be acknowledged as a component of assessing capital adequacy for insurance groups, including those active internationally.
2. **Objectivity.** RBC charges should be objective and measured at a consistent statistical safety level. RBC charges should reflect the risk exposure they are intended to measure, capturing differences in their risk distributions, with appropriate considerations for concentration, diversification, and tail risks. They should recognize differences in accounting, reserving requirements, and other offsets (e.g., taxes or discounting) and consider overall business practices and their treatment within the framework (e.g., hedging strategies).
3. **Consistency with Statutory Accounting.** RBC charges should be derived from values reported in the statutory annual statement.
4. **Emerging risks. Evaluation of emerging risks should consider:**
    a. The level and growth in exposure to the emerging risk;
    b. How quickly the risk can become materially incorporated into insurers' business;
    c. Industry exposure to the risk, as well as industry segment exposure; and
    d. Identification and measurement limitations of emerging risks.
5. **Changes to RBC calculations.**
    a. **Transparency and process.** NAIC RBC stakeholders should collaborate to identify emerging risks that potentially require changes to RBC calculations. Changes to RBC calculations shall adhere to the *NAIC Open Meeting Policy* and should be conducted transparently, allowing stakeholders reasonable time to offer feedback. Complex proposals may require a more iterative process.
    b. **Equal capital for equal risk.** RBC charges should balance the appropriateness of the existing charge with the added complexity and materiality of the possible change. Refinements to RBC calculations should aspire not to result in deviations from the principle of Equal Capital for Equal Risk.
6. **Governance.** Components of RBC calculations should adhere to Model Governance Standards that provide processes for model development, documentation standards, validation, ongoing monitoring, and change management. The calculations should be understandable and auditable by regulators. This ensures that future adjustments align with guiding principles and supporting guidelines.

All comments on this proposed preliminary Risk-Based Capital principles and responses to the listed questions should be sent by COB July 24 to NAIC staff (Dan Daveline at ddaveline@naic.org) and Bridgeway Analytics (RBC-MoGo@BridgewayAnalytics.com). Questions can also be directed to the same.